Report

of the

Examination of

Maple Valley Mutual Insurance Company

Lena, Wisconsin

As of December 31, 2002

TABLE OF CONTENTS

Page

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

September 17, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MAPLE VALLEY MUTUAL INSURANCE COMPANY
LENA, WISCONSIN

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1998 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was organized on May 23, 1891, as Maple Valley Mutual Home Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. On January 1, 1987, the company converted from a town mutual insurer licensed under ch. 612, Wis. Stat., to a nonassessable regional domestic insurer under ch. 611, Wis. Stat.

The company is licensed only in Wisconsin, and is limited by order to writing business in 16 counties.

The company is currently licensed to write property and liability insurance including umbrella coverage and worker's compensation.

The major products marketed by the company include farmowner's, homeowner's, commercial multiple peril, and a small amount of workers' compensation. The major products are marketed through independent agents. The company has approximately 138 independent agents licensed, representing 35 agencies located in northeastern Wisconsin. Agents earn 10% to 17% commission on most lines of business. Contingent commissions are also paid, based on premium volume and loss ratio.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$ 314,964	$	$ 51,278	$ 263,686
Allied lines	155,131		25,256	129,875
Farmowners multiple peril	1,945,166		316,683	1,628,483
Homeowners multiple peril	1,046,071		170,306	875,765
Commercial multiple peril	416,279		67,772	348,507
Inland marine	242,323		39,451	202,872
Workers' compensation	54,403		8,857	45,546
Other liability - occurrence	40,691		39,750	941
Total All Lines	$4,215,028	$	$719,353	$3,495,675

III. MANAGEMENT AND CONTROL

Board of Directors

The company's bylaws state that the board of directors shall consist of not less than nine, or more than fifteen members. There are currently nine directors. The directors are divided into three classes, and one class is elected at each annual meeting for a term of three years. Officers are elected at the board's organizational meeting. Except for the president, who is salaried, the board members currently receive a per diem of $150 for each meeting attended and $.34 per mile for serving on the board.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Randall M. Gomoll Luxemburg, Wisconsin	Financial Planning	2004
John L. Matravers Oconto, Wisconsin	Retail Merchandising	2004
Gary L. Wolf Bonduel, Wisconsin	Farming	2004
Donald J. Graff Lena, Wisconsin	Elementary School Principal	2005
Kenneth H. Rosner Crivitz, Wisconsin	Postal Employee	2005
Alvin H. Schuettpelz Lena, Wisconsin	President- Maple Valley Mutual	2005
Richard E. Gilles Lena, Wisconsin	Farming	2006
John E. Van Drisse Luxemburg, Wisconsin	Insurance Agent	2006
Francis J. Wranosky Oconto Falls, Wisconsin	Dairy Farmer	2006

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation
Richard Gilles	Chairman	$ 8,700
Donald Graff	Vice Chairman/Secretary	7,490
Alvin Schuettpelz	President/Treasurer	103,706
Gerald Wenzel	Vice President – Claims	65,074

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Richard Gilles
Alvin Schuettpelz
Donald Graff

Nominating Committee
Donald Graff
Kenneth Rosner
John Matravers
Alvin Schuettpelz

Investment Committee
Richard Gilles
Alvin Schuettpelz
Randall Gomoll

Adjusting Committee
Richard Gilles
Donald Graff
Alvin Schuettpelz
Gerald Wenzel

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contract contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003
Termination provisions:	Either the Company or the Reinsurer may terminate this Contract of Reinsurance and/or any of the attached exhibits as of 12:01A.M. Central Standard Time, January 1,2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A - Excess of Loss Reinsurance
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All business classified as Casualty business and Worker's Compensation, but excludes business classified as Umbrella Liability.
	Retention:	$50,000 in respect to each and every loss occurrence
	Coverage:	100% of each and every loss occurring on the business covered by this Exhibit, including loss adjustment expenses. Coverage is subject to maximum policy limits of $1,000,000 per occurrence, in any combination of bodily injury and property damage liability as respects all business other than Worker's Compensation, $1,000,000 split limits, in any combination of bodily injury and property damage liability as respects all business other than Worker's Compensation, $5,000 for medical payments, per person: $25,000 per accident, and statutory limits each occurrence or employee by disease as respects Worker's Compensation and $1,000,000 each occurrence or employee by disease as respects Employer's Liability.
	Premium	21% of the net premium earned for each and every policy issued by the company on business covered by this Exhibit.
	Effective date	January 1, 2003

	Termination	January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.
2.	Type of contract:	Umbrella Liability Combination Quota Share and Excess of Loss Reinsurance
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All business written by the company classified as Umbrella Liability
	Retention:	5% of up to $2,000,000 per occurrence.
	Coverage:	95% of losses, including loss adjustment expenses, up to $1,000,000 per occurrence. 100% of $1,000,000 in excess of $1,000,000 each loss occurrence, up to $2,000,000 limit.
	Premium:	95% of the unearned premiums applicable to business covered by this exhibit as of January 1, 2003. 95% of the premium earned for each and every policy issued by the company on business covered by this Exhibit.
	Commission:	30% of the premium paid to the reinsurer.
	Effective date	January 1, 2003
	Termination	January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.
3.	Type of contract:	Class B First Surplus Reinsurance
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All property business written by the company.
	Retention:	$600,000 per ceded risk, and at least 50% on a pro rata basis per ceded risk when the company’s net retention is $600,000 or less in respect to a risk.
	Coverage:	Up to $800,000 on a pro rata basis when the company’s net retention is $600,000 or more in respect to a risk. When the company’s net retention is $600,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk.
	Premium:	100% of the unearned premium applicable to property business. Pro rata share of all premiums, fees, and assessments charged by company corresponding to the amount of each risk ceded.
	Ceding Commission:	15% to 35%, depending on loss experience

	Effective date	The contract was effective January 1, 2003, but was amended in December 2003 to eliminate an overlap with the C-2 coverage. The above information reflects the amended contract.
	Termination	January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.
4.	Type of contract:	Class C-1 First Layer Excess of Loss
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All property business written by the company
	Retention:	$75,000 per occurrence
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $75,000, subject to a limit of liability to the reinsurer of $75,000.
	Premium:	Based on experience over the past four years with load factor of 125%. Minimum rate: 3% of current net earned premiums. Maximum rate: 15% of current net earned premiums Premium deposit: $219,000 Minimum premium of $175,000.
	Effective date	January 1, 2003
	Termination	January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.
5.	Type of contract:	Class C-2 Second Layer Excess of Loss
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All property business written by the company
	Retention:	$150,000 in respect to each and every risk resulting from one loss occurrence.
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $150,000, subject to a limit of liability to the reinsurer of $450,000.
	Premium:	3% of the company's current net premiums earned in respect to the business covered. Premium deposit: $102,000. Minimum premium of $82,000
	Effective date	January 1, 2003

	Termination	January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.
6.	Type of contract:	Class D/E First Aggregate Stop Loss & Catastrophe Reinsurance
	Reinsurer:	Wisconsin Reinsurance Corporation
	Scope:	All property business written by the company
	Retention:	Part A. – Catastrophe Coverage - The first $300,000 of net losses excluding loss adjustment expenses arising out of each loss occurrence. Part B – Stop Loss Coverage - Net losses equal to not less than 62.5% of the company's net earned premium, subject to a minimum retention of $1,900,000.
	Coverage:	Part A. – Catastrophe Coverage - 100% of the amount, if any, by which the aggregate of the company's losses, including loss adjustment expenses, exceed the retention up to a limit of $700,000 for any one loss occurrence and $1,400,000 during each annual period. Part B – Stop Loss Coverage -100% of the amount, if any, by which the aggregate of the company's net losses exceed 62.5% of the company's net earned premium.
	Premium:	Current rate based on a formula calculation which takes into account the losses incurred by the reinsurer under this contract for the last eight years. Minimum rate: 6.5% of the current net written premiums Maximum rate: 25% of the current net written premiums The rate for the current annual period is 6.5%.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Maple Valley Mutual Insurance Company
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$3,725,893	$	$3,725,893
Stocks:			
Preferred stocks	75,000		75,000
Common stocks	606,958		606,958
Real estate:			
Occupied by the company	148,683		148,683
Properties held for the production of income	61,143		61,143
Properties held for sale			
Cash	272,583		272,583
Short-term investments	708,883		708,883
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	23,930		23,930
Premiums, agents' balances, and installments booked but deferred and not yet due	697,795		697,795
Reinsurance recoverable on loss and loss adjustment expense payments	52,150		52,150
Federal and foreign income tax recoverable and interest theron	126,851	16,675	110,176
Electronic data processing equipment and software	17,011		17,011
Interest, dividends, and real estate income due and accrued	54,996		54,996
Other assets nonadmitted:			
Furniture, equipment, and supplies	13,076	13,076	
Write-ins for nonadmitted assets:			
Automobiles	38,068	38,068	
Write-ins for other than invested assets			
Contingent commissions receivable	4,195		4,195
State income taxes receivable	3,200		3,200
Total Assets	$6,630,415	$67,819	$6,562,596

Maple Valley Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Losses	$ 465,404	
Loss adjustment expenses	18,000	
Commissions payable, contingent commissions, and other similar charges	213,483	
Other expenses (excluding taxes, licenses, and fees)	2,332	
Taxes, licenses, and fees (excluding federal and foreign income taxes)	12,602	
Unearned premiums	2,124,894	
Advance premium	85,762	
Ceded reinsurance premiums payable (net of ceding commissions)	73,193	
Write-ins for liabilities:		
Reinsurance Payable to WRC	22,743	
Total Liabilities		$3,018,413
Unassigned funds (surplus)	3,544,183	
Surplus as Regards Policyholders		3,544,183
Total Liabilities and Surplus		$6,562,596

Maple Valley Mutual Insurance Company
Summary of Operations
For the Year 2002

Underwriting Income		
Premiums earned		$3,281,758
Deductions:		
Losses incurred	$2,154,586	
Loss expenses incurred	290,924	
Other underwriting expenses incurred	1,229,548	
Total underwriting deductions		3,675,058
Net underwriting gain or (loss)		(393,300)
Investment Income		
Net investment income earned	209,694	
Net realized capital gains or (losses)	1,814	
Net investment gain or (loss)		211,508
Other Income		
Write-ins for miscellaneous income:		
Policy and installment fees	127,439	
Gain on sale of property and equipment	(3,800)	
Total other income		123,639
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		(58,153)
Federal and foreign income taxes incurred		(5,800)
Net Income [Loss]		$ (52,353)

Maple Valley Mutual Insurance Company
Cash Flow
As of December 31, 2002

Premiums collected net of reinsurance	$3,467,425		
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)	2,219,788		
Underwriting expenses paid	1,173,912		
Cash from underwriting		$73,725	
Net investment income		221,476	
Other income (expenses):			
Write-ins for miscellaneous items:			
[Miscellaneous income(mainly policy fees)]	123,639		
Total other income		123,639	
Deduct:			
Federal income taxes paid (recovered)		(32,800)	
Net cash from operations			$451,640
Proceeds from investments sold, matured, or repaid:			
Bonds	1,948,086		
Stocks	165,097		
Total investment proceeds		2,113,183	
Cost of investments acquired (long-term only):			
Bonds	2,386,095		
Stocks	128,772		
Total investments acquired		2,514,867	
Net cash from investments			(401,684)
Cash provided from financing and miscellaneous sources:			
Other cash provided	105,314		
Total		105,314	
Cash applied for financing and miscellaneous uses:			
Other applications	60,587		
Total		60,587	
Net cash from financing and miscellaneous sources			44,727
Net change in cash and short-term investments			94,683
Reconciliation			
Cash and short-term investments, December 31, 2001			886,784
Cash and short-term investments, December 31, 2002			$981,467

Maple Valley Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2002

Assets	$6,562,596	
Less liabilities	3,018,413	
Adjusted surplus		$3,544,183
Annual premium:		
Lines other than accident and health	3,495,675	
Factor	50%	
Compulsory surplus (subject to a minimum of $2 million)*		1,747,838
Compulsory surplus excess (or deficit)		$1,796,345
Adjusted surplus (from above)		$3,544,183
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)	2,446,973	
Security surplus excess (or deficit)		$1,097,210

*Pursuant to s. Ins 51.80(3)(b), Wis. Adm. Code, the $2,000,000 minimum compulsory surplus does not apply to insurers, such as Maple Valley Mutual Insurance Company, that were first authorized to do business in Wisconsin prior to January 1, 1982, unless otherwise required by statute or administrative order. Such an order applies to Maple Valley Mutual Insurance Company, and it stipulates, among other things that a permanent surplus of $1,500,000 million be maintained as well as compulsory surplus of at least 50% of net premium written.

Maple Valley Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000	1999	1998
Surplus, beginning of year	$3,756,619	$3,710,892	$3,567,792	$3,430,251	$3,181,664
Net income	(52,353)	38,475	161,472	85,016	177,844
Net unrealized capital gains or (losses)	(102,862)	(94,193)	(5,839)	55,858	71,997
Change in net deferred income tax	(35,647)	37,843	0	0	0
Change in non-admitted assets	(21,574)	2,630	(12,533)	(3,333)	(1,254)
Cumulative effect of changes in accounting principles	0	60,972	0	0	0
Surplus, end of year	$3,544,183	$3,756,619	$3,710,892	$3,567,792	$3,430,251

Maple Valley Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2002

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	Ratio	2002	2001	2000	1999	1998
#1	Gross Premium to Surplus	119.0%	100.0%	94.0%	92.0%	90.0%
#2	Net Premium to Surplus	99.0	85.0	77.0	76.0	75.0
#3	Change in Net Writings	9.0	12.0	6.0	4.0	10.0
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	99.0	93.0	92.0	93.0	95.0
#6	Investment Yield	3.9*	4.9	5.0	5.1	4.7
#7	Change in Surplus	-3.0	2.0	4.0	5.0	5.0
#8	Liabilities to Liquid Assets	43.0	44.0	39.0	41.0	39.0
#9	Agents' Balances to Surplus	1.0	1.0	0.0	0.0	0.0
#10	One-Year Reserve Devel. to Surplus	1.0	0.0	0.0	-1.0	-8.0
#11	Two-Year Reserve Devel. to Surplus	2.0	0.0	1.0	-8.0	-10.0
#12	Estimated Current Reserve Def. To Surplus	-3.0	-1.0	2.0	-7.0	-1.0

Ratio No. 6, Investment Yield, measures the profitability and general quality of the company's investment portfolio over the previous two-year period. The score of 3.9 is slightly below the expected minimum result of 4.5. However, based on current market returns, this result is not unusual.

Growth of Maple Valley Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	$6,562,596	$3,018,413	$3,544,183	($52,353)
2001	6,320,839	2,564,220	3,756,619	38,475
2000	5,880,959	2,170,067	3,710,892	161,471
1999	5,810,912	2,243,120	3,567,792	85,016
1998	5,368,465	1,938,214	3,430,251	177,844

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$4,215,028	$3,495,675	$3,281,758	74.5%	31.6%	106.1%
2001	3,761,824	3,193,127	3,016,423	74.6	31.0	105.5
2000	3,473,916	2,860,813	2,771,820	67.8	31.6	99.4
1999	3,295,839	2,695,681	2,629,501	70.5	33.4	103.9
1998	3,076,898	2,587,759	2,612,621	67.3	32.2	99.5

Gross premium written and net premium written have increased by 37% and 35%, respectively over the past five years. The Loss and LAE Ratio has increased 7% over the five year period to a high of 74.5% in 2002 and 74.6% in 2001. The expense ratio has remained relatively stable over the same period, and is currently at 31.6%. The company showed a net loss in 2002, the only loss in the five year period. However, the company has experienced unfavorable underwriting results in the period under examination, with underwriting losses in each of the years. The underwriting loss in 2002, coupled with a lower investment yield and an increase in reinsurance costs, were factors in the net loss incurred.

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination:

Surplus December 31, 2002, per Annual Statement	**$3,544,183**

There was no adjustment to surplus as a result of this examination.

Examination Reclassifications

	Debit	Credit
Losses	$28,425	$
Loss Adjustment Expenses		28,425
Total reclassifications	$28,425	$28,425

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were five specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company establish procedures for disclosure to its board of directors of any material interest or affiliation on the part of any officers, directors, or responsible employees which is in or is likely to conflict with the official duties of such employee.

   Action—Compliance.

2. Bonds and Stocks—It is again recommended that securities not rated by the National Association of Insurance (NAIC) Commissioner's Securities Valuation Office be submitted for rating.

   Action—Compliance.

3. Bonds and Stocks—It is again recommended that the company hold securities under its own name as required by s. 610.23, Wis Stat.

   Action—Compliance.

4. Agents Balances— It is again recommended that direct agent commissions payable be classified as either an offset to premiums and agents balances in course of collection or as a write-in liability in accordance with the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies.

   Action—Compliance.

5. Unpaid Loss Adjustment Expenses—It is recommended that the company adopt an actuarial method in order to determine a more adequate loss adjustment expenses in the future.

   Action—Compliance.

Summary of Current Examination Results

Invested Assets

The review of investments revealed that the company required only one signature for access to the company's safety deposit box and negotiable securities, and only one signature was required on checks regardless of the amount. It is recommended that the company strengthen control over liquid assets by implementing procedures where two signatures are required for access to the safety deposit box and negotiable securities and two signatures are required on checks over a predetermined amount.

Premiums, Agents' Balances, and Installments Booked But Deferred and Not Yet Due

During the review of the premium cycle, it was noted that the company's reports for both Premiums, agents' balances, and installments booked but deferred and not yet due, and Advance premiums, included installment premiums which the company had already received. The company's software provider was made aware of the problem, and proposed to rectify the situation by the following year-end report date. No reclassification will be made as the balance is below tolerable error, and no adjustment to surplus will be made as the balances net to zero. It is recommended that the company monitor the reports produced by its software provider to ensure the balances accurately reflect both Advance premiums and Premiums, agents' balances and installments booked but deferred and not yet due.

Reinsurance Recoverables on Loss and Loss Adjustment Expense Payments

The examination noted that the company paid claims prior to year end for which it was entitled to recoveries. However, at the time of the examination the company had not yet submitted all claims paid prior to year end to its reinsurance company for reimbursement. It is recommended that the company promptly submit reinsurance recoverables on paid losses and loss adjustment expenses to its reinsurer.

EDP Equipment and Software

The review of EDP Equipment and the corresponding depreciation schedule revealed that the company is depreciating EDP equipment and software using a five-year depreciation schedule. It is recommended that the company depreciate EDP equipment and operating software over the lesser of its useful life or three years in accordance with SSAP No. 79.

Loss Adjustment Expenses

The current examination determined the company was in compliance regarding the prior examination recommendation that the company make a more reasonable estimate of the expenses necessary to adjust unpaid losses. However, it appears the company included expected payments for direct loss adjustment expenses of $28,425 as a portion of the loss reserve estimate. Additional loss adjustment expenses of $18,000, based on expected payments for indirect administrative expenses, were reported on the correct line of the annual statement. It is recommended that the company include all expected payments for costs to be incurred in connection with the adjustment and recording of losses as loss adjustment expenses on page three, line three of the annual statement, per SSAP No. 55 paragraph 5(c). A reclassification will be made reducing Loss Reserves by $28,425 to $436,979 and increasing Loss adjustment expenses by $28,425 to $46,425.

Loss Reserves

The review of loss reserves noted that the Annual Statement Schedule P was incorrectly completed The company did not include the special property lines (Schedule P, Part 1I) from the pre-2000 accident years in the Schedule P, Part 1 summary. Although only the last two years of data are required to be displayed in Part 1I, the preceding eight years must be supplemented when computing the totals in the Schedule P, Part 1 summary. It was also noted that columns four to nine in Schedule P, Part 1 should have been reported net of salvage and subrogation, rather than gross as the company reported. Subsequent to the completion of fieldwork, the company filed an amended statement that included the special property lines from the pre-2000 accident years in the Schedule P, Part 1 summary. The amended Schedule P continued to report reserves and loss payments gross of salvage and subrogation; however, the difference was not deemed material. Going forward, the company has agreed to report these figures net of salvage and subrogation.

Executive Compensation Filings/Reporting

An insurer is required to file a State of Wisconsin Report on Executive Compensation and an NAIC Supplemental Compensation Exhibit. A review of the forms determined that the company did not make complete disclosure of its director, executive, and highest paid employee's compensation during the years under examination. The company failed to include certain nonsalary considerations for directors and executives, as well as deferred benefits paid on behalf of company personnel. The following items were noted:

1) The company did not report agency commissions earned as an element of director and officer compensation for those officers and directors who are also agents for the company. The company should report the full amount of commissions paid to the director's or officer's agency, even if the director or officer owns less than 100% of the agency.

2) The company provides an automobile for its president's use. The value of the personal use portion was reported as “salary” rather than” other compensation” on the State of Wisconsin Report in 2001 and 2002. The value was correctly included in “other compensation” in the three prior years under review.

3) The company has a Company Profit Sharing Plan whereby the company makes defined contributions to the plan on behalf of its employees. The employee's share of the contribution is based on the relationship of each employee's compensation compared to the total compensation for all participants. This contribution for the officers of the company was not included in the “other compensation” column on the forms.

4) The company pays the premium on a life insurance policy for the president. The company is a beneficiary for only one-third of the policy value. The value of the benefit to the president was reported as “salary” rather than “other compensation” on the State of Wisconsin Report in 2001 and 2002. It was reported correctly in the three prior years under review.

The instructions for both forms specifically state, among other items, that compensation shall consist of any and all remuneration paid to or on behalf of a director, officer, or employee, and shall include commissions and all other forms of personal compensation. It is recommended that the company report all remuneration paid to or on behalf of a director, officer, or employee, on both the State of Wisconsin Report on Executive Compensation and the NAIC Supplemental Compensation Exhibit, as required by the respective instructions for those forms.

Fidelity Bond Coverage

The fidelity bond coverage was recalculated using the guidelines in the NAIC Financial Examiners Handbook during the review of the company's corporate insurance. The company currently bonds all employees in the amount of $100,000, while the guidelines recommend a bond of $125,000 to $150,000 for the company's exposure. It is suggested that the company increase fidelity bond coverage to more accurately reflect its current exposure.

VIII. CONCLUSION

As of December 31, 2002, the company reported assets of $6,562,596, liabilities of $3,018,413, and policyholders' surplus of $3,544,183. This examination resulted in one reclassification between accounts with no adjustment to surplus as a result of this examination.

During the period under examination, the company increased admitted assets by 22% and surplus by 3% overall, although there was a reduction in surplus in the current year. This was due to the combination of unfavorable underwriting results and a lowered investment yield. At the same time, liabilities increased 55%. The company is experiencing a steady growth in premium volume, with a 37% increase over the past five years. The Loss and LAE ratio has increased 7%, to 75%, while the expense ratio has shown a slight decrease to the current 32%. Despite unfavorable underwriting results, the company was able to post a positive net income in four of the past five years.

The prior examination resulted in five recommendations, of which the company was in compliance with all. The current examination resulted in six recommendations and one suggestion, which are summarized in the following "Summary of Comments and Recommendations" section of this report.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 20 - Invested Assets—It is recommended that the company strengthen control over liquid assets by implementing procedures where two signatures are required for access to the safety deposit box and negotiable securities and two signatures are required on checks over a predetermined amount.

2. Page 20 - Premiums, Agents' Balances and Installments Booked But Deferred and Not Yet Due—It is recommended that the company monitor the reports produced by its software provider to ensure the balances accurately reflect both Advance premiums and Premiums, agents' balances and installments booked but deferred and not yet due.

3. Page 20 - Reinsurance Recoverables on Loss and Loss Adjustment Expense—It is recommended that the company promptly submit reinsurance recoverables on paid losses and loss adjustment expenses to its reinsurer

4. Page 21 - EDP Equipment and Software — It is recommended that the company depreciate EDP equipment and operating software over the lesser of its useful life or three years in accordance with SSAP No. 79.

5. Page 21 - Loss Adjustment Expenses — It is recommended that the company include all expected payments for costs to be incurred in connection with the adjustment and recording of losses as loss adjustment expenses on page three, line three of the annual statement, per SSAP No. 55 paragraph 5(c).

6. Page 23 - Executive Compensation Filings/Reporting — It is recommended that the company report all remuneration paid to or on behalf of a director, officer, or employee on both the State of Wisconsin Report on Executive Compensation and the NAIC Supplemental Compensation Exhibit as required by the respective instructions for those forms.

7 Page 23 Fidelity Bond Coverage — It is suggested that the company increase fidelity bond coverage to more accurately reflect its current exposure.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Bridgot Quandt	Insurance Financial Examiner

Respectfully submitted,

Jean Suchomel
Examiner-in-Charge